

1 interest rates, used as a rough rule of thumb, suggests that the
2 cost of capital has fallen dramatically.

3 **Q. DOES THE JULY 18, 2000 DECISION OF THE U.S. COURT OF APPEALS**
4 **FOR THE EIGHTH CIRCUIT AFFECT THE ESTIMATION OF THE COST**
5 **OF CAPITAL FOR UNE'S?**

6 A. No. Even if the decision withstands further review, it should have no effect on
7 determining the forward-looking economic cost of capital. The court objected to UNE
8 costs based on "...some state of the art presently available technology ideally
9 configured but neither deployed by the ILEC nor to be used by the competitor... ."
10 Notably, the Eighth Circuit Court also rejected the use of historical "sunk" costs and
11 reaffirmed the principle of forward-looking costs,

12 We reiterate that a forward-looking cost calculation
13 methodology that is based on the incremental costs that an
14 ILEC actually incurs or will incur in providing the
15 interconnection to its network or the unbundled access to its
16 specific network elements requested by a competitor will
17 produce rates that comply with the statutory requirement of
18 Sec. 252(d)(1) that an ILEC recover its "cost" of providing the
19 shared items.⁴⁵

20 My cost of capital methodology is based on forward-looking market
21 expectations regarding the performance and risk of the telephone holding companies in
22 my sample, not on explicit assumptions regarding the network architectures or types of
23 technologies that are to be priced in UNE cost proceedings.

1 **Q. SHOULD THE COST OF CAPITAL ESTIMATE ACCOUNT FOR**
2 **QUARTERLY COMPOUNDING?**

3 A. The cost of capital rate that will be determined in this proceeding will be used as a
4 mechanism to compensate VZ-VA. It is Verizon's investors that receive their
5 dividends quarterly, not VZ-VA. Telephone operating companies like VZ-VA receive
6 payments for the use of their network elements on a monthly basis, and consequently,
7 are able to reinvest their cash flows on an approximate monthly basis. This is a more
8 frequent basis than investors receive their quarterly dividends from the telephone
9 holding companies. Thus, the effective rate that the telephone operating companies
10 receive is the allowed rate— as determined in this hearing— compounded monthly,
11 regardless of the fact that a telephone holding company pays dividends to investors
12 quarterly. If the Commission allows a rate which is estimated using a quarterly
13 compounding DCF model, VZ-VA will get an effective rate compounded both
14 quarterly (as allowed) and monthly (as actually received).

15 For comparison, think of a public company which is not subject to rate
16 regulation. Such a company would never be able to sell services or products to
17 customers at an agreed price, and then demand that the customers increase those
18 payments by adding quarterly compounded interest to it. It is clear that the unregulated
19 public company never gets the benefit of quarterly compounding. It gets the benefit of
20 depositing customer payments into the bank and earning compounded interest on those

⁴⁵ United States Court of Appeals for the Eighth Circuit, No. 96-3321, (July 18, 2000).

1 revenues net of expenses. It then pays its investors quarterly, who reinvest the
2 dividends and thus get the benefit of quarterly compounding.

3 To be precise, therefore, if quarterly compounding is allowed, the cost of equity
4 would also have to be "decompounded" to account for the fact that the telephone
5 holding companies will be able to reinvest proceeds on a monthly basis. The net effect
6 would result in a lower allowed rate than the annual DCF cost of equity proposed by
7 me. Consequently, the use of a DCF cost of equity determined using the annual
8 formula is conservatively high.

9 **Q. SHOULD THE COST OF CAPITAL ESTIMATE BE INCREASED FOR**
10 **EQUITY FLOTATION COSTS?**

11 A. No. Verizon and the other telephone companies in the sample are large holding
12 companies whose stocks trade on the NYSE in an efficient market. As part of the
13 process of arriving at the day-to-day prices for the companies' stock, the market is
14 anticipating future events which affect the cash flows that the companies will earn.
15 This process clearly includes the anticipation of future cash expenditures, including
16 financing costs for both debt and equity which reduce the companies' cash flows.
17 Because the price of the companies' stock has accounted for flotation costs already, an
18 estimation of the cost of equity using the DCF model accurately reflects the required
19 return of investors. Adding a flotation cost adjustment would in effect double count
20 the cost of financing.

21 **Q. IF YOUR THEORETICAL ARGUMENT REGARDING FLOTATION COSTS**
22 **IS CORRECT, WHY HAS THERE BEEN SO MUCH DISCUSSION ON THIS**

1 ISSUE IN THE TRADITIONAL REGULATORY RATE HEARING

2 CONTEXT?

3 A. The regulatory context is really a different issue. In the regulatory world, a main
4 purpose is to identify costs which can be charged back to the ratepayers by the
5 telephone operating company. Equity flotation costs have often been disallowed
6 because it would not be fair to burden current ratepayers with all of those costs if the
7 equity capital would be utilized indefinitely. One way that parties have tried to
8 “amortize” these costs so that they could be recovered by the telephone company is to
9 make the flotation cost adjustment to the allowed return, which would in effect charge
10 it back to ratepayers perpetually in very small increments. This is not the issue for this
11 proceeding. In this case, I am interested in the forward-looking cost of capital which
12 fairly compensates for the riskiness of the business. Because telephone holding
13 companies' stock trades efficiently, the market has assessed its prospective cash flows,
14 including financing costs, to arrive at its estimate of the fair price.

15
16 IX. CONCLUDING SUMMARY

17 Q. COULD YOU SUMMARIZE THE MAIN CONCLUSIONS OF YOUR
18 TESTIMONY.

19 A. Using publicly-available data and accepted finance procedures I have estimated that the
20 weighted average cost of capital for VZ-VA's provision of UNEs as of June 30, 2000 is
21 in a range between 9.17 and 9.91 percent with a best point estimate of **9.54** percent.

1 I have also stressed, however, that at least the higher side of the range
2 represents an upward-biased estimate of the cost of capital for the provision of network
3 elements because it incorporates the risks of multi-business telephone holding
4 companies. In this proceeding, VZ-VA's business at issue is not a diversified
5 telephone holding company, but a company in the more specialized (and less risky)
6 business of providing UNEs.

7 Finally, I observed public information made available by independent parties
8 unrelated to this proceeding that confirm the reasonableness of my cost of capital
9 estimate.

10 **Q. DOES THAT CONCLUDE YOUR PRESENT TESTIMONY?**

11 **A. Yes.**

I, JOHN I. HIRSHLEIFER hereby swear and affirm that the foregoing direct testimony was prepared by me or under my direct supervision or control and is true and accurate to the best of my knowledge and belief.

Signed:

John I. Hirshleifer
Witness

State :
County :

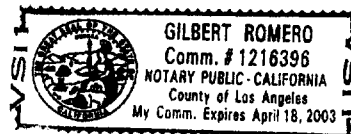
I, Gilbert Romero do hereby swear and affirm that John Israel
Hirshleifer appeared before me this 18 day of July, 2001.

Signed:

[Signature]
Notary

Notary Qualification Expires: 4/18/03

[Stamp or Seal]



**Charles
River
Associates**

JOHN I. HIRSHLEIFER – Vice President

EDUCATION AND PROFESSIONAL CERTIFICATION

M.B.A. Concentration in Finance, University of California, Los Angeles, 1980

B.A. Political Science, University of California, Los Angeles, *magna cum laude*, 1976

 Certified Public Accountant, California

LICENSES HELD

Registered securities representative (Series 7 license)

General securities principal (Series 24 license)

Financial operations principal (Series 27 license)

Licensed real estate broker in the State of California

PROFESSIONAL MEMBERSHIPS

California Society of Certified Public Accountants

PUBLICATIONS

“Estimating the Cost of Equity Capital.” With Bradford Cornell and Elizabeth P. James.
Contemporary Finance Digest, FMA International/CIBC Wood Gundy, Autumn 1997, Vol. 1,
No. 1, p. 5.

PROFESSIONAL POSITIONS

2001-present *Vice President*, Charles River Associates Incorporated

1999–2001 *Principal*, Charles River Associates Incorporated.



**Charles
River
Associates**

1990–1999 *Vice President, Director of Research, FinEcon.* Testified before state public utility commissions regarding the cost of capital applicable to the provision of telephone network elements and universal service by local exchange companies. Testified at deposition and trial regarding economic and financial issues related to business damages, valuation, cost of capital, and securities matters.

Managed consulting and valuation engagements dealing with a broad variety of issues including damages estimation in business disputes; the development of cost of capital estimation methodologies; valuation of intangible assets; estimation of minority and liquidity discounts; insider trading; fraud-on-the-market damages and class certification issues; the impact of information disclosures on stock price movements; the economic substance of stock and futures trading strategies; analyses of complex derivative securities; analyses of mergers, acquisitions, and restructurings; analyses of high-yield bonds; the risk characteristics of fixed income portfolios; analysis of viability of asbestos liability compensation funds; and antitrust matters.

Representative industry experience includes securities and mutual funds, telecommunications, healthcare, computer peripherals, entertainment, banking, food service, real estate, oil and gas, biotechnology, consumer electronics, and insurance.

1985–1990 *Director of Due Diligence, Transamerica Financial Resources, Inc., Los Angeles, CA.* As financial principal, oversaw all financial regulatory filings and coordinated financial aspects of periodic NASD and SEC audits. Supervised all securities due diligence and proprietary partnership origination activities of Transamerica broker-dealer affiliate. Coordinated and analyzed the work of due diligence staff, outside securities and tax attorneys, accountants, private detectives, and other third-party experts in the course of due diligence investigation of securities considered for sale by the broker-dealer.

Reviewed investment opportunities for proprietary syndication or direct brokerage, including potential real estate, cable television, equipment leasing, and film financing investments; inspected property sites; prepared financial analyses and projections; negotiated terms of acquisitions, partnership participations, and loans; wrote, reviewed, and edited offering documents and contracts.

Consulted for other Transamerica companies regarding acquisitions, including venture capital opportunities, and qualifications and performance records of asset managers. Established Registered Investment Adviser affiliate company.



**Charles
River
Associates**

Supervised administration of previously syndicated proprietary partnerships including oversight of property management performance; investor reporting; partnership legal, treasury, accounting, tax, and financial reporting functions.

Coordinated litigation matters for proprietary limited partnerships; directed litigation strategies in conjunction with cost-benefit analyses of alternative actions; testified at deposition and trial. Licensed real estate affiliate to promote Asian investment in Transamerica-brokered real estate and securities; made presentations to top management of major Japanese and Taiwanese corporations regarding real estate investment in the United States.

Elected Treasurer & Financial Principal of Transamerica Financial Resources in 1988.

Elected Second Vice President of Transamerica Financial Resources in December 1985.

1980–1984 *Senior Tax Consultant*, Price Waterhouse, Century City, CA. Responsible for corporate, partnership, trust, and individual client matters including tax research and planning, review and supervision of tax compliance and projections, and preparation of financial cash flow analyses. Supervised and performed audits of corporate and partnership clients. Prepared projections for privately syndicated limited partnerships. Supervised writing of tax opinion letters and co-authored comments to the U.S. Treasury Department regarding proposed income tax regulations.



Telephone Holding Companies

Company	Market Value of Equity at 6/30/00 (\$ mil)	1999 Revenues (\$ mil)	1999 Book Value of Plant (\$ mil)	Access Lines in Service (mil)
<u>RBHC's</u>				
Verizon	151,800	33,174	39,299	64.5
BellSouth	80,200	25,224	24,631	17.2
SBC Communications	147,124	48,960	46,571	61.2
<u>Large Independent Telephone Holding Companies</u>				
ALLTEL	19,528	6,302	5,532	2.5
Century Telephone Ent	4,032	1,677	2,257	1.3

Sources: Standard & Poor's Industry Survey; Value Line Inc.; 10-Ks.

Bell Atlantic Bond Yields as of June 30, 2000

	S&P DEBT RATING	Debt Outstanding at Par (mil \$)	Yield to Maturity as of 6/30/00
<u>Bell Atlantic--N.J. (was New Jersey Bell Tel.)</u>			
Deb 5 7/8s 2004	A+	250	7.25%
<u>New Jersey Bell Tel. (Now Bell Atlantic--N.J.)</u>			
Deb 4 7/8s 2000	A+	20	7.02%
Deb 7 1/4s 2002	A+	100	6.86%
Deb 4 5/8s 2005	A+	40	7.07%
Deb 5 7/8s 2006	A+	55	7.28%
Deb 6 5/8s 2008	A+	50	7.41%
Deb 7 1/4s 2011	A+	125	7.80%
Deb 7 3/8s 2012	A+	75	7.90%
Deb 8s 2022	A+	200	7.96%
Deb 7 1/4s 2023	A+	100	8.07%
Deb 6.80s 2024	A+	100	8.07%
Deb 7.85s 2029 (HRO on 11-15-99 at 100)	A+	150	8.00%
<u>Bell Atlantic--PA</u>			
Deb 6 2028	A+	125	7.98%
<u>Bell Tel. of Penna (Now Bell Atlantic--Pennsylvania)</u>			
Deb 4 3/4s 2001	A+	50.0	7.08%
Deb 6 5/8s 2002	A+	100	7.09%
Deb 4 3/8s 2003	A+	50.0	7.24%
Deb 6 1/8s 2003	A+	150	7.17%
Deb 7 3/8s 2007	A+	150	7.64%
Deb 6 3/4s 2008	A+	100	7.47%
Deb 7 1/8s 2012	A+	75.0	8.07%
Deb 7.70s 2023	A+	100	8.27%
Deb 8.35s 2030 (HRO on 12-15-00 & 02 at 100)	A+	175	7.96%
Deb 8 3/4s 2031	A+	125	8.00%
Deb 7 3/8s 2033	A+	225	8.27%
<u>Chesapeake Pot. Tel Md (Now Bell Atlantic-Maryland)</u>			
Deb 4 3/8s 2002	A+	50	7.25%
Deb 6s 2003	A+	200	7.28%
Deb 5 7/8s 2004	A+	60	7.31%
Deb 6 5/8s 2008	A+	75	7.65%
Deb 7 1/4s 2012	A+	50	8.16%
Deb 7.15s 2023	A+	250	8.13%
Deb 8s 2029 (HRO on 10-15-96 @ 100)	A+	50	7.99%
Deb 8.30s 2031	A+	100	8.06%

Bell Atlantic Bond Yields as of June 30, 2000

	S&P DEBT RATING	Debt Outstanding at Par (mil \$)	Yield to Maturity as of 6/30/00
<u>Chesapeake & Pot. Tel Va (Now Bell Atlantic-Virginia)</u>			
Deb 7 1/8s 2002	A+	100	7.39%
Deb 5 1/4s 2005	A+	50	7.52%
Deb 6 1/8s 2005	A+	100	7.53%
Deb 5 5/8s 2007	A+	65	7.59%
Deb 6 3/4s 2008	A+	70	7.77%
Deb 7 1/4s 2012	A+	50	8.16%
Deb 7 5/8s 2012	A+	100	7.82%
Deb 7 7/8s 2022	A+	100	7.89%
Deb 7 1/4s 2024	A+	75	8.19%
Deb 7s 2025	A+	125	8.19%
Deb 8 3/8s 2029 (HRO on 10-1-99 @ 100)	A+	100	8.05%
<u>Chesapeake & Pot. TelWashDC (Now Bell Atlantic-Washington D.C.)</u>			
Deb 5 5/8s 2006	A+	25	7.73%
Deb 7s 2009	A+	50	7.53%
Deb 7 3/4s 2023	A+	90	8.26%
<u>Chesapeake & Pot. Tel W Va (Now Bell Atlantic - West Virginia)</u>			
Deb 6.05s 2003	A+	50	7.39%
Deb 7s 2004	A+	50	7.32%
Deb 7 1/4s 2013	A+	50	8.06%
<u>Diamond State Telephone (Now Bell Atlantic-Delaware)</u>			
Deb 6 1/8s 2003	AA-	20	7.22%
Deb 4 5/8s 2005	AA-	7	7.26%
Deb 7s 2008	AA-	10	8.03%
Deb 8 3/8s 2019	AA-	15	7.90%
Deb 7s 2023	AA-	20	7.98%
Deb 8 5/8s 2031	AA-	15	8.04%
<u>NYNEX Capital Funding</u>			
(Gtd) M-T Nts 'B' 8.06s 2001	A+	10.0	7.39%
(Gtd) M-T Nts 'B' 8.22s 2001	A+	65.0	7.39%
(Gtd) M-T Nts 'B' 8.40s 2001	A+	10.0	7.39%
(Gtd) M-T Nts 'B' 8.32s 2004	A+	10.0	7.46%
(Gtd) M-T Nts 'B' 8 3/4s 2004	A+	150.0	7.47%
(Gtd) M-T Nts 'B' 8.61s 2006	A+	10.0	7.70%

Bell Atlantic Bond Yields as of June 30, 2000

	S&P DEBT RATING	Debt Outstanding at Par (mil \$)	Yield to Maturity as of 6/30/00
<u>New York Telephone Co.</u>			
Ref M 4 5/8s 2002	A+	60	7.49%
Ref O 4 5/8s 2004	A+	130	8.04%
Ref P 4 7/8s 2006	A+	100	7.89%
Ref Q 6s 2007	A+	75	7.46%
Ref V 7 3/8s 2011	A+	200	7.77%
Deb 6 1/2s 2005	A+	200	7.89%
Deb 6s 2008	A+	250	7.87%
Deb 6 1/8s 2010	A+	250	7.78%
Deb 8 5/8s 2010	A+	150	8.39%
Deb 7s 2013	A+	100	7.74%
Deb 7s 2013	A+	100	7.69%
Deb 7 5/8s 2023	A+	100	8.34%
Deb 6.70s 2023	A+	250	8.12%
Deb 7 1/4s 2024	A+	450	7.62%
Deb 7s 2025	A+	250	8.13%
Deb 6 1/2s 2028	A+	100	7.93%
Deb 9 3/8s 2031	A+	200	8.77%
Deb 7s 2033	A+	200	7.99%
Nts 5 7/8s 2003	A+	200	8.10%
Nts 5 5/8s 2003	A+	150	7.36%
Nts 6 1/4s 2004	A+	150	8.96%
<u>New England Tel. & Tel</u>			
Deb 4 1/2s 2002	A+	50	7.79%
Deb 4 5/8s 2005	A+	60	7.58%
Deb 6 1/8s 2006	A+	100	7.92%
Deb 6 3/8s 2008	A+	125	7.80%
Deb 7 7/8s 2022	A+	100	7.92%
Deb 6 7/8s 2023	A+	250	8.22%
Deb 7 7/8s 2029	A+	350	7.72%
Deb 9s 2031	A+	100	8.58%
Nts 8 5/8s 2001	A+	100	8.00%
Nts 7.65s 2007	A+	125	7.60%
Nts 6 1/4s 2003	A+	225	7.75%
Nts 5 7/8s 2009	A+	200	7.77%
Weighted Average:		10,567	7.84%

Source: Standard & Poor's Bond Guide, July 2000.

GTE Bond Yields as of June 30, 2000

	S&P DEBT RATING	Debt Outstanding at Par (mil \$)	Yield to Maturity as of 6/30/00
<u>GTE Florida</u>			
Deb 'A' 6.31s 2002	A+	200	7.37%
Deb 'B' 7.41s 2023	A+	200	8.14%
Deb 'C' 7 1/4s 2025	A+	100	8.14%
Deb 'D' 6 1/4s 2005	A+	100	7.35%
Deb 'E' 6.86s 2028	A+	300	7.98%
<u>GTE California</u>			
Deb 'A' 5 5/8s 2001	A+	300	7.37%
Deb 'B' 6 3/4s 2004	A+	250	7.48%
Deb 'C' 8.07s 2024	A+	250	8.27%
Deb 'D' 7s 2008	A+	100	7.85%
Deb 'E' 6.70s 2009	A+	300	7.82%
Deb 'F' 6 3/4s 2027	A+	200	8.04%
Deb 'G' 5 1/2s 2009	A+	225	7.82%
Deb 'H' 7.65s 2007	A+	275	7.69%
<u>GTE Corp.</u>			
Deb 9 3/8s 2000	A+	500	7.27%
Deb 9.10s 2003	A+	500	7.60%
Deb 6.36s 2006	A+	450	7.60%
Deb 6.46s 2008	A+	250	7.81%
Deb 7.51s 2009	A+	500	7.80%
Deb 6.84s 2018	A+	600	7.94%
Deb 10 1/4s 2020	A+	400	9.62%
Deb 8 3/4s 2021	A+	300	7.94%
Deb 7.83s 2023	A+	500	8.39%
Deb 7.90s 2027	A+	500	8.39%
Deb 6.94s 2028	A+	800	7.99%
M-T Nts 'A' 6.39s 2000	A+	100	6.39%
M-T Nts 'A' 6.56s 2002	A+	105	7.06%
M-T Nts 'A' 6.60s 2005	A+	75	7.20%
<u>GTE Hawaiian Tel</u>			
1st BB 6 3/4s 2005	A+	125	7.87%
Deb 'A' 7s 2006	A+	150	8.03%
Deb 7 3/8s 2006	A+	150	8.16%

GTE Bond Yields as of June 30, 2000

	S&P DEBT RATING	Debt Outstanding at Par (mil \$)	Yield to Maturity as of 6/30/00
<u>GTE North Inc.</u>			
1st 8 1/2s 2031	A+	250	8.59%
Deb 'A' 6s 2004	A+	250	7.46%
Deb 'C' 7 5/8s 2026	A+	200	8.24%
Deb 'D' 6.90s 2008	A+	250	7.82%
Deb 'E' 6.40s 2005	A+	150	7.49%
Deb 'F' 6 3/8s 2010	A+	200	7.85%
Deb 'G' 6.73s 2028	A+	200	8.04%
Deb 'H' 5.65s 2008	A+	250	7.82%
<u>GTE Northwest (was Gen'l Tel. Northwest)</u>			
Deb 'A' 7 3/8s 2001	A+	200	7.38%
Deb 'B' 7 7/8s 2026	A+	175	8.29%
Deb 'C' 6.30s 2010	A+	175	7.77%
Deb 'D' 5.55s 2008	A+	200	7.72%
<u>GTE South Inc.</u>			
Deb 7 1/4s 2002	A+	150	7.32%
Deb 'C' 6s 2008	A+	125	7.80%
Deb 'D' 7 1/2s 2026	A+	250	8.13%
Deb 'E' 6 1/8s 2007	A+	225	7.67%
<u>GTE Southwest</u>			
1st 8 1/2s 2031	A+	100	8.04%
Deb 'B' 6.54s 2005	A+	250	7.51%
Deb 'C' 6s 2006	A+	150	7.64%
Deb 6.23s 2007	A+	150	7.76%
Weighted Average:		12,705	7.88%

Source: Standard & Poor's Bond Guide, July 2000.

**BELL ATLANTIC - GTE
WEIGHTED AVERAGE COST OF DEBT
INCLUDED IN STANDARD & POOR'S BOND GUIDE
AS OF JUNE 30, 2000**

	Debt at Par Per July S&P Bond Guide <u>(\$ millions)</u>	Weighted Average <u>Yield to Maturity</u>
Bell Atlantic	\$10,567	7.84%
GTE	\$12,705	7.88%
Weighted Average Cost of Debt:		7.86%

Source: Attachments 3-a and 3-b

**3-Stage DCF Model Estimates of Cost of Equity
For Telephone Holding Companies**

Company	5-year I/B/E/S Forecast Growth Rate as of 6/00 Sustainable Growth Rate					COST OF EQUITY		
						15-yr Linear Convergence (A)	Weighted Average Excluding Company (B)	Cost of Equity $1/4 \times (A) + 3/4 \times (B)$
Verizon (7/3/00)	\$55.000	\$1.54	3.1%	11.65%	6.29%	11.07%	9.96%	10.24%
BellSouth	\$42.625	\$0.80	1.9%	11.07%	6.29%	9.13%	10.69%	10.30%
SBC Communications	\$43.250	\$1.02	2.4%	12.87%	6.29%	10.34%	10.41%	10.39%
ALLTEL	\$61.938	\$1.34	2.2%	14.41%	6.29%	10.49%	10.37%	10.40%
CenturyTel	\$28.750	\$0.22	0.8%	14.79%	6.29%	7.96%		

NM - Not Meaningful.

Sources: Standard and Poors; Value Line, Inc.; I/B/E/S; WEFA; Ibbotson Associates.

Estimated Betas For the Comparable Companies

Ticker Symbol	Company	BARRA Levered Beta	BARRA Unlevered Beta	Re-levering of Average Unlevered Beta Using Company's Capital Structure
VZ	Verizon	0.682	0.56	0.77
BLS	BellSouth	0.645	0.57	0.71
SBC	SBC Communications	0.825	0.74	0.70
AT	ALLTEL	0.742	0.65	0.72
CTL	CenturyTel	0.841	0.64	0.83
Assumed Tax Rate:		37.5%		
Value-Weighted Average Unlevered Beta			0.63	

Sources: *finance.yahoo.com* and Attachment JH-10.

Risk Premium Computed from DCF Expected Market Return

	Expected Long- Run Yield As Of June 30, 2000	Merrill Lynch Expected Return on Stock Market ⁽¹⁾	Implied Risk Premium
1-Month Treasury Bill	4.93%	10.20%	5.27%
20-Year Treasury Bond	6.26%	10.20%	3.94%

(1) From Alcar

Expected Long-Run One-Month Treasury Bill Yield For June 30, 2000

Calculation of Historical Term Premium for Long-Term Treasury Bonds over One-Month Treasury Bills

<u>Average Long-Term Treasury Bond Return</u>		<u>Average One-Month Treasury Bill Return</u>		<u>Historical Term Premium</u>
5.12%	-	3.79%	=	1.33%

Estimation of Long-Run Treasury Bill Yield Based on Historical Term Premium

<u>Long-Term Treasury Bond Yield June 30, 2000</u>		<u>Historical Term Premium</u>		<u>Long-Run Expected Treasury Bill Yield June 30, 2000</u>
6.26%	-	1.33%	=	4.93%

Sources: Federal Reserve Weekly Bulletin, Ibbotson Associates.

Stock Market Premium Analysis

<u>Year</u>	<u>Stock Returns</u>	<u>One-month Treasury Bill Returns</u>	<u>Long-Term Treasury Bond Total Returns</u>
Period	Arithmetic Average	Arithmetic Average	Arithmetic Average
1802-1999 ⁽¹⁾⁽²⁾	9.95%	4.31%	5.04%
1926-1999 ⁽²⁾	13.28%	3.83%	5.50%
1951-1999 ⁽²⁾	14.49%	5.27%	6.19%
1971-1999 ⁽²⁾	15.27%	6.73%	9.47%
<u>Period</u>		<u>Stock Premium Over Bills</u>	<u>Stock Premium Over Bond Total Returns</u>
1802-1999		5.63%	4.91%
1926-1999		9.45%	7.78%
1951-1999		9.23%	8.31%
1971-1999		8.53%	5.79%
<u>Year</u>	<u>Stock Returns</u>	<u>One-month Treasury Bill Returns</u>	<u>Long-Term Treasury Bond Total Returns</u>
Period	Geometric Average	Geometric Average	Geometric Average
1802-1999 ⁽¹⁾⁽²⁾	8.55%	4.22%	4.81%
1926-1999 ⁽²⁾	11.35%	3.79%	5.12%
1951-1999 ⁽²⁾	13.27%	5.23%	5.67%
1971-1999 ⁽²⁾	14.07%	6.70%	8.83%
<u>Period</u>		<u>Stock Premium Over Bills</u>	<u>Stock Premium Over Bond Total Returns</u>
1802-1999		4.33%	3.74%
1926-1999		7.56%	6.23%
1951-1999		8.04%	7.59%
1971-1999		7.37%	5.25%

⁽¹⁾ Jeremy J. Siegel, "Stocks for the Long-Run", (New York: Irwin), 1994.

⁽²⁾ *Stocks, Bonds, Bills and Inflation, 2000 Yearbook*, Ibbotson Associates, Chicago, Illinois.

**Model Estimates of Cost of Equity
as of June 30, 2000
For RBOC's, ALLTEL, and CenturyTel**

Company	DCF Weighted Cost of Equity	Beta	CAPM Cost of Equity			COST OF EQUITY (AVERAGE of DCF and CAPM Average)
			1-month Treasury Bills	20-yr Treasury Bonds	Average	
Verizon	10.24%	0.77	10.71%	10.50%	10.60%	10.42%
BellSouth	10.30%	0.71	10.26%	10.17%	10.21%	10.26%
SBC Communications	10.39%	0.70	10.18%	10.11%	10.15%	10.27%
ALLTEL	10.40%	0.72	10.33%	10.22%	10.28%	10.34%
CenturyTel	NM	0.83	11.16%	10.83%	10.99%	10.99%

NM - Not Meaningful.

Capital Structure of Telephone Holding Companies
As of 6/30/00

Company	Short-Term Debt	Long-Term Debt	BASED ON BOOK VALUE			BASED ON MARKET VALUE		
			Total Debt	Preferred Stock	Common Equity	Total Debt	Preferred Stock	Common Equity
Verizon	18%	30%	49%	0%	51%	26%	0%	74%
BellSouth	18%	32%	51%	0%	49%	17%	0%	83%
SBC Communications	18%	29%	48%	0%	52%	15%	0%	85%
ALLTEL	1%	46%	46%	0%	54%	19%	0%	81%
CenturyTel	2%	49%	51%	0%	49%	33%	0%	67%
Value-Weighted Average:			49%	0%	51%	20%	0%	80%

Sources: Companies' SEC Forms 10-Q for 2Q 2000; market value of common equity based on closing stock price as of June 30, 2000.

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

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**FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY**

In the Matter of)
Petition of WorldCom, Inc. Pursuant)
To Section 252 (e)(5) of the)
Communications Act for Expedited)
Preemption of the Jurisdiction of the)
Virginia State Corporation Commission)
Regarding Interconnection Disputes)
With Verizon Virginia, Inc., and for)
Expedited Arbitration)

CC Docket No. 00-218

In the Matter of)
Petition of Cox Virginia Telecom, Inc.)
Pursuant to Section 252 (e)(5) of the)
Communications Act for Preemption)
Of the Jurisdiction of the Virginia State)
Corporation Commission Regarding)
Interconnection Disputes with Verizon)
Virginia, Inc. and for Arbitration)

CC Docket No. 00-249

In the Matter of)
Petition of AT&T Communications)
Virginia Inc., Pursuant to Section 252 (e)(5))
of the Communications Act for Preemption)
of the Jurisdiction of the Virginia)
Corporate Commission Regarding)
Interconnection Disputes with Verizon)
Virginia, Inc.)

CC Docket No. 00-251

DIRECT TESTIMONY OF RICHARD B. LEE

ON BEHALF OF AT&T¹ AND WORLDCOM, INC.

July 31, 2001

¹ The AT&T entities sponsoring this Direct Testimony are AT&T Communications of Virginia, Inc., TCG Virginia, Inc., ACC National Telecom Corp., MediaOne of Virginia and MediaOne Telecommunications of Virginia, Inc. (together, "AT&T").

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